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Contractor's accounting report to his banker

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The Contractor's Accounting Report to His Banker

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It amazes me how little has been written concerning the accounting problems and reports of the construction industry, particularly in light of the many special problems that the contractor has in operating his business and determining income. Being a risk industry, one would expect the contractor to start his contract with a margin of profit sufficient to allow him to sustain a certain amount of unforeseen losses and still come out with a reasonable profit. Such is not the case. The industry is highly competitive and if a contractor puts too much padding in his bid, he finds someone else is awarded the contract.

Different contracts require different skills and experience, not all of which may be possessed by a contractor when he enters his bid; nevertheless, he must give a firm price at which he will perform the work. Normally, his work must be completed within a specified time. Regardless of weather conditions, excavation delays, labor troubles or other conditions that might arise to delay the work, the time schedule must be met, or the contractor pays. Indeed, it seems rather remarkable that a contractor can make a bid low enough to be awarded a contract and still make any profit unless lady luck is one of his major stockholders.

With all of these problems, most contractors have the additional problem of financing the construction. Payments from his customer, in almost every case, come only after a portion of the work has been completed and even then a percentage is normally withheld until the final completion of the project. Because of the large amounts of money involved, most contractors are faced with the problem of financing the construction until such time as payment can be received from the customer. The primary source of these funds is, of course, the commercial bank and the contractor ends up across the desk from one of you. We see, then, that in doing business with a contractor, the banker is faced with many problems beyond those faced in the normal credit situation. Fortunately, I need be concerned with only one of those problems, the contractor's accounting report.

In considering the contractor's accounting report, let us start with the basic method of accounting employed. There are two basic methods of accounting - cash and accrual. Obviously, the cash method of accounting is not suitable for a contractor. We are left, then, with the accrual method and it, too, is inappropriate in its normal concept.

The principal difficulty in fitting the contractor's accounting into the accrual system lies in the determination of income. Billings on contracts are not made on the same considerations as normally exist in the accrual method. This is true with respect both to the time and amount of billing. The terms of the contract may provide for billing ahead of or behind the progress of the contract. The billings are usually subject to a retainage by the customer which will not be paid until the contract has been finally completed and accepted. The amounts billed vary widely in relation to cost incurred by the contractor, his profits, and stages of completion of the project. It is evident then, that income to be recognized at any point of time cannot be measured by billings.

Out of the need for an adequate and consistent method of reporting income by contractors, there have arisen two widely used methods of recording income and our discussion here today will center upon those two methods - the percentage-of-completion method and the completed-contract method. Each of these methods is recognized for Federal income tax purposes. Under Federal regulations, the contractor may use either method but must use the method selected for all of his qualifying contracts consistently from year to year, unless he obtains permission to change.

Considering first the percentage-of-completion method - How does it work? The percentage-of-completion method recognizes earned income as the work on a contract progresses. Costs are charged against income as incurred. The determination of the amount of income earned is the problem. The total income is the contract price and that, of course, is known. Under this method, we must determine how much of that total contract price will be taken into income during the accounting period. There are various methods of arriving at that amount. The method most frequently used is to take into income that percentage of the total contract that the incurred costs through the end of the period bear to the estimated total costs of the contract. That is, the costs to complete the contract are estimated, added to the incurred costs, and the ratio of the incurred costs to that total is the percentage of the total contract taken into income.

The amount to be taken into income can be obtained by other methods. It can be the percentage of the total job which has been completed as estimated by the construction engineers. It can be the costs incurred plus a percentage of costs for profit - this would likely be the method used where the contracts are on the cost-plus-a-percentage basis or the cost-plus-a-fixed-fee basis. The amount to be taken into income can be determined by cost accounting methods. For example, it could be the income earned based upon the contract bid where the amount bid through any stage of completion can be determined from the job records. The danger in this method is that the income will be distorted where unbalanced bids had been submitted in which the costs of the early work on the contract have been overestimated with a corresponding underestimation of the costs of the latter stages of the work.

In certain types of construction, the amount to be taken into income might be derived by use of a suitable unit of measurement such as yards of concrete poured, as, say in road construction, if costs vary in approximately the same proportion as the number of such units.

Turning now to the completed-contract method - How does it work? The completed-contract method recognizes income only when a contract is completed. Accordingly, the costs of contracts in progress are accumulated and no charge or credit to income is made until the contract is completed. Generally a contract may be considered completed if the remaining costs to be incurred are not significant in amount. Billings under this method are not credited to income but rather are accumulated and applied against the costs incurred in financial reports.

When the completed-contract method is used, it is necessary to consider what costs are to be charged to the uncompleted contracts and thereby deferred. Direct and indirect contract costs are of course so charged. In addition, it will often be appropriate to allocate general and administrative expenses to the contracts rather than to charge them against periodic income. Conservative accounting would indicate, however, that the allocation of general and administrative expenses to contracts should be kept at a minimum. The allocation of these expenses will necessarily depend upon the circumstances and the problems would vary considerably as between the cases where, on the one hand, no contracts are completed during the year, and on the other, where numerous projects and contracts are being completed at all times during the year.

So much for a description of the two methods of accounting commonly applied to contracts. Now, when do we use one as opposed to the other?

The principal advantage of the percentage-of-completion method is that it gives periodic recognition of income currently as the work takes place rather than irregular recognition as contracts are completed. It is theoretically the more accurate of the two methods, although less conservative, and it would prevent the wide yearly fluctuations in income which could result from the completed-contract method. The principal disadvantage of the percentage-of-completion method is that it is necessarily dependent upon estimates of ultimate cost which are subject to the many uncertainties inherent in long-term contracts.

The principal advantage of the completed-contract method is that it is based upon results as finally determined. The principal disadvantage of this method is that it does not reflect current performance when the contract extends into more than one accounting period. This may result in irregular recognition of income which could distort the operational result of the contractor when compared over a period of years.

The selection of the method, then, should be geared to the practical considerations of the contractor's particular type of operations. If estimates of costs to complete or the extent of progress toward completion are reasonably dependable, the percentage-of-completion method is preferable. When these estimates cannot be reasonably determined, the completed-contract method is preferable.

After the contractor has selected his method of accounting and has maintained his books in accordance with the method selected, he is ready to make a financial report. Let us now consider that report and some of the things it should contain.

First, the report should clearly state the method of accounting the contractor is using. This should not be left to the guesswork of the reader of the statements.

Second, a provision should be made for expected losses in accordance with the well-established accounting practice of making provision for foreseeable losses. This applies when either method is used, even though under the completed-contract method income is not recognized prior to contract completion. If there is a close relationship between profitable and unprofitable contracts, such as in the case of contracts which are parts of the same project, the group may be treated as a unit in determining the necessity for a provision for losses. Here again the treatment must be determined by the circumstances of the particular case.

Turning now to balance sheet presentation, terminology, and supporting schedules, I am going to show you some statements from reports which have been rendered on contractor's accounts, including some examined by C.P.A.'s.

Before looking at these statements, let me say that I am not necessarily criticizing them for their form or content because, so far as I know, no concerted effort has ever been made to standardize form or content. Further, as you well know, audit reports are issued for different purposes and what might be desirable in a report for credit purposes, might not be desirable or suitable in a report, say, to stockholders. I am not here concerned, nor do my remarks apply to the disclosure necessary in an audit report to reflect clearly a company's financial position. My purpose is to set forth what I believe a financial report, whether audited or not, should contain with respect to those accounts peculiar to the contractor, when the report is presented to a banker for credit purposes.

These statements have been changed to the extent necessary to prevent their identification and to eliminate those items which are not material for our present purposes.

So that I shall not keep you here all day, I will not discuss each statement, but merely point out wherein they differ.

First, we have seven statements on contractors using the percentage-of-completion method of accounting.

Statement (1)

(a) Trade receivables are presented without subdivision or supporting details.

(b) A schedule of contract income and costs is included in the statement of operations.

ASSETS

CURRENT ASSETS:		
Cash		$ 20,000
Accounts receivable:		
Trade	$150,000	
Sub-contractors	50,000	
Employees	2,000	202,000
FIXED ASSETS*		500,000
DEFERRED CHARGES*		5,000
OTHER ASSETS*		20,000
Total assets		$747,000

*Details omitted.

STATEMENT OF OPERATIONS

	Gross Income	Construction Costs	Income or (Loss)
Construction projects:			
Job 170	$250,000	$210,000	$40,000
Job 190	120,000	105,000	15,000
Job 192	210,000	190,000	20,000
Job 198	270,000	290,000	(20,000)
Totals	$850,000	$795,000	$55,000
Other construction costs*			20,000
Gross income from construction			$35,000
General and administrative expenses			50,000
Loss before other income and expenses			$15,000

Supporting schedule gives details of costs by jobs.
*Details omitted.

Statement (2)

(a) Receivables are presented without subdivision but the details of the total amount are given.

(b) "Funds invested in uncompleted contracts" is carried as a current asset although the percentage-of-completion method is apparently used.

(c) The details of contract income and costs are given.

ASSETS

CURRENT ASSETS:	
Cash	$ 50,000
Accounts Receivable - Exhibit C	300,000
Funds invested in uncompleted contracts - Exhibit C . .	30,000
Total current assets	$380,000
INVESTMENTS*	10,000
FIXED ASSETS*	100,000
OTHER ASSETS*	20,000
Total Assets	$510,000

STATEMENT OF OPERATIONS

INCOME:		
Gross profit on contracts - Exhibit C-1	$100,000	
Income on completed jobs	15,000	
Other	1,000	
Gross income		$116,000
GENERAL OVERHEAD EXPENSE*		50,000
Net profit for period		$ 66,000

*Details omitted.

GROSS PROFIT ON CONTRACTS (EXHIBIT C)

% OF COMP.	NAME OF OWNER	REVENUE EARNED	CONST. COST	TOTAL PROFIT	PROFIT FOR YEAR	F. I. IN U. C.**	ACCTS. REC. (MEMO)
60	ABC Co.	$ 20,000	$ 14,000	$ 6,000	$ 6,000		$ 15,000
100	DEF Co.	5,000	4,000	1,000	1,000		5,000
10	GHI Co.	50,000	60,000	(10,000)		$10,000	50,000
90	JKL Co.	500,000	460,000	40,000	40,000		60,000
100	MNO Co.	70,000	60,000	10,000	10,000		
50	PQR Co.	300,000	265,000	35,000	35,000		90,000
40	STU Co.	20,000	26,000	(6,000)		6,000	20,000
70	VWX Co.	100,000	92,000	8,000	8,000		60,000
	YZA Co.		14,000	(14,000)		14,000	
Total.		$1,065,000	$995,000	$70,000	$100,000	$30,000	$300,000

**Funds invested in uncompleted contracts.

Statement (3)

(a) Receivables are presented without subdivision but details are given showing retainage and aging.

(b) "Deferred Job Income" is shown as a non-current liability.

(c) The details of contract income and cost are given, including the percentage of gross profit.

BALANCE SHEET

ASSETS

CURRENT ASSETS:	
Cash	$ 10,000
Accounts receivable - Trade (Schedule 1)	100,000
Inventories and work in progress	5,000
Total current assets	$115,000
FIXED ASSETS*	50,000
DEFERRED CHARGES*	1,000
Total Assets	$166,000

LIABILITIES

CURRENT LIABILITIES*	$ 65,000
DEFERRED JOB INCOME	20,000
NET WORTH*	81,000
Total Liabilities and Capital	$166,000

*Details omitted.

GROSS PROFIT FROM CONSTRUCTION OPERATIONS (EXHIBIT D)

	JOB INCOME	COST OF CONSTRUCTION (EXHIBIT E)	GROSS PROFIT (LOSS)	PERCENTAGE GROSS PROFIT
ABC Co . . .	$200,000	$172,000	$28,000	14%
DEF Co . . .	250,000	225,000	25,000	10%
GHI Co. . . .	100,000	88,000	12,000	12%
JKL Co . . .	50,000	55,000	(5,000)	(10%)
Total . . .	$600,000	$540,000	$60,000	10%

Exhibit E gives details of cost of construction.

ACCOUNTS RECEIVABLE - TRADE (SCHEDULE 1)

	TOTAL	RETAINED THROUGH JUNE 30, 1955	JUNE BILLINGS EXCLUSIVE OF RETAINER	BILLINGS PRIOR TO JUNE
ABC Co . .	$ 50,000	$20,000	$30,000	
DEF Co . .	30,000	10,000	20,000	
GHI Co . .	15,000		15,000	
JKL Co . .	5,000		4,000	$1,000
Total . .	$100,000	$30,000	$69,000	$1,000

Statement (4)

(a) Receivables are subdivided into those due currently and those due on completion of the contract.

(b) A deduction is made to reduce the receivables to the earned estimates.

(c) No supporting details are given.

ASSETS

CURRENT ASSETS:		
Cash		$ 200,000
Accounts receivable:		
Due currently.	$500,000	
Due on completion	150,000	
Other	20,000	
Total.	$670,000	
Less amount required to adjust accounts receivable to engineer's earned estimates. .	70,000	600,000
Prepaid expenses - Insurance and other		1,000
Total current assets		$ 801,000
FIXED ASSETS*.		500,000
GOODWILL*.		25,000
Total Assets.		$1,326,000

*Details omitted.

Statement (5)

(a) Receivables are subdivided into reserved amounts and earned estimates - the details are given of each classification.

(b) "Deferred construction costs" is shown under the caption "Deferred Charges".

ASSETS

CURRENT ASSETS:		
Cash		$ 200,000
Receivables:		
Due from other contractors	$ 20,000	
Reservation on contracts	150,000	
Estimates on contracts	20,000	190,000
Inventories		20,000
Total current assets		$ 410,000
FIXED ASSETS*		1,500,000
DEFERRED CHARGES:		
Prepaid bonds	$ 3,000	
Deferred construction costs - Net, contracts in progress	50,000	53,000
Total Assets		$1,963,000

*Details omitted.

SCHEDULE OF ESTIMATES AND RESERVATION RECEIVABLE

JOB NUMBER	AMOUNT OF CONTRACT	AMOUNT EARNED	AMOUNT RECEIVED	RESERVATION RECEIVABLE	CURRENT ESTIMATES RECEIVABLE
101. . . .	$ 400,000	$ 350,000	$ 315,000	$ 35,000	
106. . . .	550,000	500,000	470,000	25,000	$ 5,000
110.......	300,000	300,000	270,000	30,000	
120. . . .	450,000	400,000	370,000	20,000	10,000
125. . . .	750,000	600,000	570,000	30,000	
130. . . .	200,000	200,000	185,000	10,000	5,000
Total	$2,650,000	$2,350,000	$2,180,000	$150,000	$20,000

Statement (6)

(a) Receivables are subdivided into those for completed contracts and those for uncompleted contracts.

(b) No separation of receivables on uncompleted contracts is made between the amount due currently and retainage.

(c) No supporting schedules are given.

ASSETS

CURRENT ASSETS:		
Cash		$ 60,000
Notes receivable		30,000
Accounts receivable - Completed jobs		150,000
Earned estimates and retainage on uncompleted jobs		200,000
Accrued interest receivable		1,000
Other work in progress		3,000
Total current assets		$444,000
FIXED ASSETS*		10,000
OTHER ASSETS*		2,000
Total Assets		$456,000

*Details omitted.

Statement (7)

(a) Receivables are subdivided into those billed and due currently, retained, and unbilled earned estimates.

(b) Accompanying schedules presented:

(1) Amounts receivable by customers and contracts for each classification.

(2) Materials, supplies, and work in progress by contracts and locations.

(3) Sales, costs, and gross profit or loss, by contracts.

ASSETS

CURRENT ASSETS:		
Cash		$ 500,000
Receivables:		
For contract work performed:		
Billed - Due currently	$300,000	
Retained - Due upon completion of contracts	100,000	
Unbilled work - Estimates earned	100,000	
Other	50,000	550,000
Materials, supplies, and work in progress to be charged to costs of contracts as work progresses		300,000
Total current assets		$1,350,000
PROPERTY AND EQUIPMENT*		1,500,000
DEPOSITS AND PREPAID EXPENSES		50,000
Total Assets		$2,900,000

*Details omitted.

There they are, seven statements on the same type of business, each employing the same accounting method. To this variety of presentations, I would add my own version, which I would preface with these remarks.

When the percentage-of-completion method is used, current assets should include amounts currently collectible (that is, collectible within one year of the balance sheet date), including amounts billed and due, amounts retained by customers from billings and unbilled earned income and costs. For your purposes, each classification should be separately shown and supported by details, including aging, of at least the larger amounts.

Liabilities, normally current liabilities, should include billings in excess of earned estimates or incurred costs.

For your purposes, under either method of accounting, materials inventories should be segregated into those which are being held for use on contracts and those which constitute general purpose inventories.

With those remarks, I present my suggested balance sheet for a percentage-of-completion method contractor.

PERCENTAGE-OF-COMPLETION METHOD
SUGGESTED BALANCE SHEET

ASSETS

CURRENT ASSETS:		
Cash		$200,000
Receivables:		
For contract work performed:		
Billed - Due currently	$300,000	
Retained - Due upon completion of contracts	50,000	
Unbilled work - Estimates earned	75,000	
Other	10,000	435,000
Materials in stock (at cost):		
To be charged to contracts in progress . . .	$100,000	
Other materials	50,000	150,000
Total current assets		$785,000
FIXED ASSETS*		200,000
DEFERRED CHARGES*		10,000
Total Assets		$995,000

*Details omitted.

LIABILITIES

CURRENT LIABILITIES:	
Notes payable	$300,000
Accounts payable	150,000
Federal and State income taxes	150,000
Billings for contract work performed in excess of earned estimates	50,000
Accrued liabilities	30,000
Total current liabilities	$680,000
CAPITAL STOCK AND SURPLUS*	315,000
Total Liabilities	$995,000

*Details omitted.

Regardless of the balance sheet presentation, it seems to me that the heart of the financial report for your purposes is the supporting information given concerning the contracts. This supporting information should include the details of the receivables, the contract income and costs, and the amounts billed.

We have seen various types of supporting schedules. Again, I would add my own version. Since I have heard that you would prefer one schedule to two, I have combined all of the information on one schedule, although the information relative to the receivables might be included on a separate schedule which would also show the aging of the accounts billed and due currently.

PERCENTAGE-OF-COMPLETION METHOD

SUMMARY OF CONTRACTS
(SHOWN VERTICALLY FOR CONVENIENCE)

	TOTAL	.... CONTRACTS.............		
General description:				
Contract number. .		101	102	103
Customer		ABC Co.	DEF Co.	GHI Co.
Location of job. . .		Charlotte, N.C.	Greensboro, N.C.	Durham, N.C.
Nature of work. . .		Office Bldg.	Warehouse	Shopping Center
Contract completion date		12/1/55	6/30/56	12/31/56
Basis of percentage of completion		Ratio of Costs	Ratio of Costs	Ratio of Costs
Amount of contract.	$1,500,000	$400,000	$100,000	$1,000,000
Estimated percentage of completion		90%	50%	18%
Estimated amount of contract earned:				
Total	$ 590,000	$360,000	$ 50,000	$ 180,000
Earned in prior years	40,000	40,000		
Earned current year	$ 550,000	$320,000	$ 50,000	$ 180,000
Current year costs incurred	495,000	280,000	45,000	170,000
Current year profit or (loss)	$ 55,000	$ 40,000	$ 5,000	$ 10,000
Amounts billed ...	$ 565,000	$295,000	$ 40,000	$ 230,000
Excess of:				
Estimated amount of contract earned over amounts billed	$ 75,000	$ 65,000	$ 10,000	
Amounts billed over estimated amount of contract earned....	$ 50,000			$ 50,000
Uncollected portion of amounts billed:				
Billed - Due currently......	$ 300,000	$150,000	$ 30,000	$ 120,000
Retained - Due upon completion of contracts	50,000	25,000	4,000	$ 21,000
Total	$ 350,000	$175,000	$ 34,000	$ 141,000

And now turning to the completed-contract method statement, we have five statements rendered on contractor's accounts employing this method.

Statement (1)

(a) Note "Jobs under construction - Advances".

(b) Apparently, no billings have been made.

(c) No supporting details are given.

ASSETS

CASH IN BANKS	$ 20,000
JOBS UNDER CONSTRUCTION - ADVANCES	170,000
Total current assets	$190,000
FIXED ASSETS*	60,000
OTHER ASSETS*	1,000
Total Assets	$251,000

Statement (2)

(a) Expenditures on uncompleted jobs are presented with collections - not billings - being deducted. Billings on uncompleted contracts are not shown.

(b) The details of contract income, costs, collections and receivables are shown in separate schedules for completed and uncompleted contracts.

ASSETS

CURRENT ASSETS:		
Cash		$ 10,000
Accounts receivable:		
Balances due on completed jobs - Exhibit C.	$ 40,000	
Other	1,000	41,000
Uncompleted jobs - Exhibit D:		
Expenditures	$500,000	
Less collections	400,000	100,000
Total current assets		$151,000
FIXED ASSETS*.		100,000
PREPAID EXPENSES.		3,000
Total		$254,000

*Details omitted.

STATEMENT OF PROFIT ON COMPLETED JOBS AND UNCOLLECTED BALANCES THEREON (EXHIBIT C)

Job number.	TOTAL	101	102	103
Amount of fee	$800,000	$400,000	$300,000	$100,000
Costs:				
Balance, January 1, 1954	$400,000	$200,000	$150,000	$ 50,000
Charges during year	300,000	150,000	120,000	30,000
Total.	$700,000	$350,000	$270,000	$ 80,000
Profit or (loss)	$100,000	$ 50,000	$ 30,000	$ 20,000
Fees receivable:				
Collections.	$760,000	$370,000	$290,000	$100,000
Uncollected balances	$ 40,000	$ 30,000	$ 10,000	

STATEMENT OF UNCOMPLETED JOBS, AND COSTS AND COLLECTIONS THEREON (EXHIBIT D)

Job number	Total	104	105	106
Amount of fee recorded	$900,000	$300,000	$400,000	$200,000
Costs:				
Balance, January 1, 1954	$200,000	$125,000	$ 75,000	
Charges during year	300,000	150,000	100,000	$ 50,000
Total.	$500,000	$275,000	$175,000	$ 50,000
Collections on fees .	$400,000	$250,000	$150,000	

Statement (3)

(a) Costs of uncompleted contracts are included under inventories.

(b) Collections against contracts are shown as a current liability.

(c) No supporting details are given.

ASSETS

CURRENT ASSETS:	
Cash	$100,000
Accounts receivable - Trade	50,000
Inventories:	
Equipment units (at cost)	10,000
Materials and supplies (at cost or less)	20,000
Equipment in process of installation (at cost)	50,000
Total current assets	$230,000
FIXED ASSETS*	100,000
PREPAID EXPENSES*	2,000
Total	$332,000

LIABILITIES

CURRENT LIABILITIES:	
Accounts payable	$ 50,000
Customers' advances on equipment contracts	30,000
Federal and State income taxes	5,000
Other accrued liabilities*	5,000
Total current liabilities	$ 90,000
CAPITAL STOCK AND SURPLUS	242,000
Total	$332,000

*Details omitted.

Statement (4)

(a) "Cost of contracts in progress" is shown net of the amounts billed to customers.

(b) Accompaning schedules presented:

(1) Gross profit by customers and ratio of gross profit to total contract charges.

(2) Aging of accounts receivable separately for completed and uncompleted contracts. A note indicated that amounts retained by customers were included in last month's totals.

ASSETS

CURRENT ASSETS:	
Cash	$ 200,000
Accounts receivable - Customers	500,000
Cost of contracts in progress less amounts billed to customers	600,000
Total current assets	$1,300,000
FIXED ASSETS*	800,000
DEFERRED CHARGES*	10,000
Total	$2,110,000

*Details omitted.

Statement (5)

(a) Costs of uncompleted contracts are shown with billings being deducted.

(b) "Billings on contracts in progress in excess of costs expended" is included in current liabilities.

(c) A note to this balance sheet states that it excludes amounts retained by customers, on uncompleted contracts, which are due after completion under the terms of the related contracts. The amount of such retainage is stated.

(d) No details of receivables or contracts are given.

ASSETS

CURRENT ASSETS:		
Cash		$100,000
Accounts receivable		200,000
Contracts in progress	$600,000	
Less billed on contracts in progress, not in excess of costs expended	500,000	100,000
Inventories - At cost		200,000
Total current assets		$600,000
FIXED ASSETS*		300,000
DEFERRED CHARGES		50,000
Total		$950,000

LIABILITIES

CURRENT LIABILITIES:	
Accounts payable	$100,000
Salaries and wages accrued	50,000
Taxes - Federal income	150,000
Billings on contracts in progress in excess of costs expended	70,000
Total current liabilities	$370,000
CAPITAL STOCK AND SURPLUS*	580,000
Total	$950,000

*Details omitted.

There are the five statements. Certainly there are as many variations as with the percentage-of-completion method statements.

Before I make my contribution, let me state my position on the completed-contract statement presentation of contract costs and billings.

When the completed-contract method is used, the excess of accumulated costs over related billings should be included in current assets when they will be recovered within a year from the balance sheet date. The excess of billings over the related costs should be shown as a liability, in most cases a current liability. Where billings in excess of costs are found on certain contracts, normally other contracts will be found on which the costs exceed billings. I believe the two situations should be segregated so that the figures on the asset side would include only those contracts for which costs exceed billings and those on the liability side would include only those for which billings exceed costs. Only in the case of closely related contracts do I believe there is a justification for aggregating costs and billings.

With that said, for what it is worth, I present my suggested balance sheet form for the completed-contract method contractor.

COMPLETED CONTRACT METHOD

SUGGESTED BALANCE SHEET

ASSETS

CURRENT ASSETS:		
Cash		$ 200,000
Receivables:		
For contract work performed:		
Completed contracts	$200,000	
Uncompleted contracts:		
Due currently	200,000	
Retained - Due upon completion of contracts	50,000	
Other	10,000	460,000
Costs of uncompleted contracts	$500,000	
Less amounts billed, not in excess of related costs	400,000	100,000
Materials in stock (at cost):		
To be charged to contracts in progress . . .	$200,000	
Other materials	50,000	250,000
Total current assets		$1,010,000
FIXED ASSETS*.		200,000
DEFERRED CHARGES*		10,000
Total		$1,220,000

LIABILITIES

CURRENT LIABILITIES:	
Notes payable	$ 300,000
Accounts payable	300,000
Federal and State income taxes	150,000
Billings on uncompleted contracts in excess of related costs	50,000
Accrued liabilities	30,000
Total current liabilities	$ 830,000
CAPITAL STOCK AND SURPLUS*	390,000
Total	$1,220,000

*Details omitted.

Again, however, you need to go further than the balance sheet and I have prepared a suggested supporting schedule for use with the completed-contract method of accounting. This schedule is designed for the presentation of uncompleted contracts. A simpler but similar schedule should be used for completed contracts.

COMPLETED CONTRACT METHOD

SUMMARY OF UNCOMPLETED CONTRACTS
(SHOWN VERTICALLY FOR CONVENIENCE)

	TOTAL	....	CONTRACTS	....
General description:				
Contract number. .		101	102	103
Customer.		ABC Co.	DEF Co.	GHI Co.
Location of job. . .		Charlotte, N.C.	Greensboro, N.C.	Durham, N.C.
Nature of work. . .		Office Bldg.	Warehouse	Shopping Center
Contract completion date		12/1/55	6/30/56	12/31/56
Amount of contract.	$1,500,000	$400,000	$100,000	$1,000,000
Costs incurred:				
Beginning of the year	$ 50,000	$ 50,000		
During the year . .	450,000	250,000	$ 50,000	$ 150,000
Total	$ 500,000	$300,000	$ 50,000	$ 150,000
Estimated costs to complete	840,000	50,000	40,000	750,000
Total	$1,340,000	$350,000	$ 90,000	$ 900,000
Estimated profit or (loss) upon completion	$ 160,000	$ 50,000	$ 10,000	$ 100,000
Amounts billed . . .	$ 450,000	$210,000	$ 40,000	$ 200,000
Excess of:				
Costs incurred over amounts billed	$ 100,000	$ 90,000	$ 10,000	
Amounts billed over costs incurred	$ 50,000			$ 50,000
Uncollected portion of amounts billed:				
Due currently . . .	$ 200,000	$ 50,000	$ 10,000	$ 140,000
Retained - Due upon completion of contracts	50,000	20,000	10,000	20,000
Total	$ 250,000	$ 70,000	$ 20,000	$ 160,000

One further observation. Frequently, you will find investments in joint ventures on the contractor's balance sheet. These investments may be included in current or other assets depending on the circumstances. In these situations, you should get a separate report on the joint venture - if possible, as of the same date as the contractor's statements. The same principles we have been discussing apply to the joint venture, which is a separate business entity, and the same information should be supplied.

That covers what I think you should get in the contractor's financial report.

Perhaps the more important topic is how are you going to get it.

The American Institute of Accountants Committee on Accounting Procedure is now working on a bulletin on the subject of accounting for construction-type contracts. When issued, this bulletin should go far to standardize the terminology and presentation used in contractor's financial reports. (Note - Accounting Research Bulletin Number 45 entitled "Long-Term Construction-Type Contracts" was issued in October 1955.)

I would not put the burden on you to educate my profession, but as in most fields of endeavor, cooperation between interested parties produces results. Our local C.P.A. Association has arranged joint meetings between our members and local bankers, meetings which have been beneficial to both groups. Similar meetings on the topic that we have discussed today will do more to bring about the rendition of reports that fit your needs than anything I know. Particularly will such meetings be helpful if they include the contractors and their accountants so that they may be made aware of your needs.

As a profession, we want very much to render the type of report which will help you in meeting your responsibilities as credit men. As your customer, I am certain that the contractor has the same desire. Working together, we can achieve the desired type of report.